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National Taxpayer Advocate's

2007 Objectives Report to Congress

June 30, 2006

AREAS OF EMPHASIS

Section 7216 Regulations Governing the Use or Disclosure of Tax Return Information by Return Preparers

Each year, a significant majority of America's taxpayers pay preparers to prepare their income tax returns for them. These taxpayers should feel confident that the personal information they provide to preparers about their incomes, expenses, family relationships, and the like will be kept in strict confidence. In fact, section 7216 of the Internal Revenue Code generally prohibits return preparers from using tax return information for any purpose other than preparing a return, and from disclosing tax return information to third parties. However, the existing regulations interpreting this statute were written in 1974 – long before anyone contemplated electronic tax return preparation and filing, or the widespread use of offshore persons to assist in preparing U.S. tax returns. These regulations do not provide adequate privacy protection in today's world. Last year, revised regulations under IRC § 7216 were issued in proposed form, and we will continue to encourage the IRS and the Treasury Department to finalize them quickly, with some modifications.

Neither section 7216 nor the existing regulations define the central terms "use" and "disclose." As a result, the field is wide open for return preparers to decide for themselves what constitutes a use or a disclosure.

Under the existing regulations, a tax return preparer, with taxpayer consent, may *use* tax return information to promote nontax products and services currently offered by the preparer or a member of the preparer's affiliated group. Moreover, with taxpayer consent, a preparer may *disclose* (and even sell) tax return information to anyone. The regulations impose no limitations on this disclosure. And once tax return information is *disclosed* to a third party, the tax code does not limit that party's ability to *re-disclose* the information. The taxpayer may never know how, when, or to whom his personal and confidential information is re-disclosed.

The distinction between "use" and "disclosure" is significant. In the "use" environment, the tax return preparer himself is holding onto information he already has and is using it to evaluate the appropriateness of a product or service for the taxpayer's situation. The taxpayer has agreed to the preparer's use – but not disclosure – of the data, and if the preparer uses the data in a manner that the taxpayer has not agreed to, the preparer may be subject to civil and criminal sanctions. In the "disclosure" environment, on the other hand, the tax return preparer can send tax return information out to any third person on the open market, where the information can be used in any manner whatsoever, without limitation. There is no way that the taxpayer can know in advance how and by whom his tax return information will be used once it is disclosed.

The regulations provide that a taxpayer may waive the privacy protections of IRC § 7216 by granting "consent" to the preparer to use or disclose his personal tax

information. In drafting the proposed regulations and a related draft revenue procedure, the IRS, Treasury, and I wrestled with many competing concerns and points of view, both within and outside the IRS. Ultimately, we agreed to focus on provisions designed to ensure that taxpayers gave *informed* consent – that is, they are clearly informed about what they are being asked to agree to, including the scope, term, and limitations of that agreement. These provisions are very specific, as I described in my testimony before the Senate Finance Committee on April 4, 2006.

Some consumer groups have criticized the proposed regulations for failing to provide strong enough taxpayer protections. In some respects, these groups have a valid point. When the existing regulations were written in 1974, taxpayers primarily paid tax preparers to prepare their tax returns. Today, however, more and more tax preparation businesses view tax preparation merely as a hook to get customers in the door so they can sell them other, more lucrative products. Once tax preparation businesses have a taxpayer's financial information and sit down to discuss taxes with the taxpayer, the businesses often try to persuade the taxpayer to take out a refund anticipation loan (RAL), establish an individual retirement account (IRA) with an affiliate or business partner, refinance a home mortgage with an affiliate or business partner, or purchase some other product. As a result, taxpayers with limited financial sophistication often end up paying high fees for products that are not suitable for them.

When taxpayers are exploited in this manner, public confidence in the integrity of the tax system suffers. That result is bad for the affected taxpayers, of course, and it may also have a negative effect on voluntary compliance. To better protect taxpayers, I believe that taxpayer consent to the use or disclosure of their tax return information should be limited to only those instances where it is necessary for tax-related purposes. The regulations should define what purposes are "tax-related." I do not believe that releasing tax return information for purposes of obtaining a RAL is "tax-related." I do not believe that releasing tax return information to a bank – whether affiliated or unaffiliated with the preparer – to obtain an IRA or mortgage refinancing is "tax-related." In the first instance, the government should provide a method for taxpayers, including the unbanked, to receive the refund of their hard-earned dollars quickly and without charge. In the second instance, the taxpayer should provide his or her own tax information to the financial institution. Any resulting inconvenience would be minor compared to the risk to the tax system of widespread use and disclosure of confidential tax return information.[6]

[6] The National Taxpayer Advocate supports an exception in the existing regulations that allows return preparers engaged in the practice of law or accounting to use the tax return information of the taxpayer, or disclose the information to other persons in the same firm, to render other legal or accounting services to or for the benefit of the taxpayer. For example, an attorney who prepares a tax return may use the information or share it with another attorney in the firm for the purpose of preparing estate planning documents for the taxpayer. *See* Treas. Reg. § 301.7216-2(e).

Over the coming year, I will work with the IRS and the Treasury to try to incorporate this and other improvements in the proposed regulations. But I want to emphasize that by virtually any standard, the proposed regulations provide far more protection than the existing regulations. It would be extremely unfortunate if concerns that the proposed regulations don't go far enough end up sinking them, because that outcome would leave the existing regulations intact and the existing regulations are clearly inadequate.

Tax Increase Prevention & Reconciliation Act Of 2005 - Partial Payments With Submissions Of Offers In Compromise[7]

The recent enactment of Section 509 of P.L. 109-223, the Tax Increase Prevention & Reconciliation Act of 2005, has the potential to eliminate offers in compromise as a viable collection alternative for many taxpayers. Enacted on May 17, this provision requires taxpayers who submit "lump-sum" offers to make a down payment of 20 percent of the amount of the offer with any offer submission. By definition, any taxpayer who submits a viable offer based on doubt as to collectibility does not have liquid assets sufficient to fund the offer. For such offers to be accepted by the IRS, a taxpayer must offer the net equity in their assets plus their future income for several years.[8] Because taxpayers do not have immediate access to future income, they must fund their offers with loans, gifts or assets that the IRS would not otherwise be able reach, and which may be costly to access. Thus, we expect that requiring taxpayers to make such nonrefundable payments will reduce the number of viable offers the IRS receives, increase the number of accounts not resolved, and reduce the amount of revenue collected.

In addition, the legislation will encourage taxpayers to submit low-ball offers, which would require a lower down payment. The IRS might well respond by rejecting the offers or not processing them, so that no significant dialog takes place.[9] The Joint Committee on Taxation estimated that the OIC legislation would raise $715,000,000 through 2010 and $1,955,000,000, almost two billion, through 2015.[10] The National Taxpayer Advocate is concerned that the legislation will have a dramatically different outcome. We believe that the IRS's existing processes, which do not result in many accepted offers, are leaving dollars on the table, and are concerned that the legislation, which erects another

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[7] H.R. 4297, Tax Increase Prevention and Reconciliation Act of 2005 (Enrolled as Agreed to or Passed by Both House and Senate), Sec. 509.

[8] The number of years varies based on the payment term: four for cash offers, five years for short term deferred payment offers, or the period remaining before expiration of the statute of limitations period for collection for deferred payment offers. *See* Form 656, *Offer In Compromise*, 6 (Rev. 7-2004).

[9] However, IRC § 7122(c)(3)(A) provides that an offer cannot be rejected solely on the basis of the amount offered.

[10] *See* Joint Committee on Taxation, *Estimated Revenue Effects of The Conference Agreement for The "Tax Increase Prevention and Reconciliation Act of 2005,"* JCX-18-06 (May 9, 2006), *available at* http://finance.senate.gov/sitepages/leg/leg050906rev.pdf.